# The Evolving Strategic Environment – A View From K Street and Wall Street

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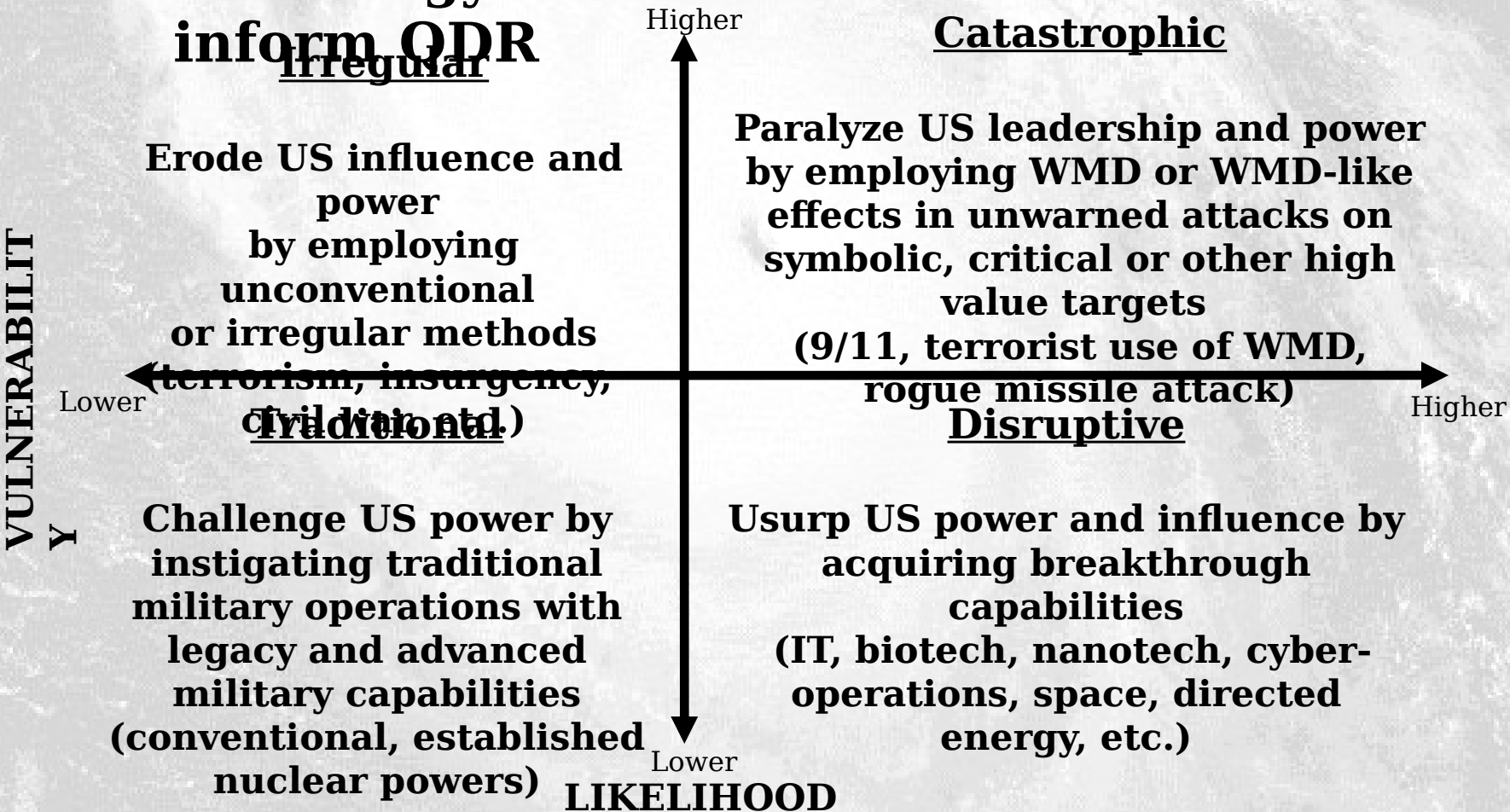
# The Evolving Landscape…

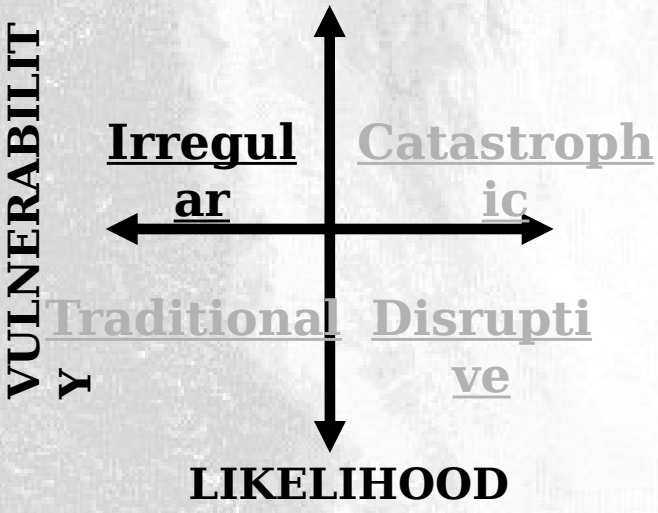
- **The Strategic Issues**
- **The Constraints**
- **Implications for Industry**

# The QDR…

- First post-911 QDR
- Strategy documents created and able to inform QDR


Higher
Irregular
Catastrophic
Erode US influence and power by employing unconventional or irregular methods (terrorism, insurgency, civil war, etc.)
Paralyze US leadership and power by employing WMD or WMD-like effects in unwarned attacks on symbolic, critical or other high value targets (9/11, terrorist use of WMD, rogue missile attack)
VULNERABILITY
Lower
Higher
Traditional
Disruptive
Challenge US power by instigating traditional military operations with legacy and advanced military capabilities (conventional, established nuclear powers)
Usurp US power and influence by acquiring breakthrough capabilities (IT, biotech, nanotech, cyber-operations, space, directed energy, etc.)
Lower
LIKELIHOOD

# Irregular Threats…




## Historically

- Solved with Traditional forces
- SOCOM ($6.5 billion budget)

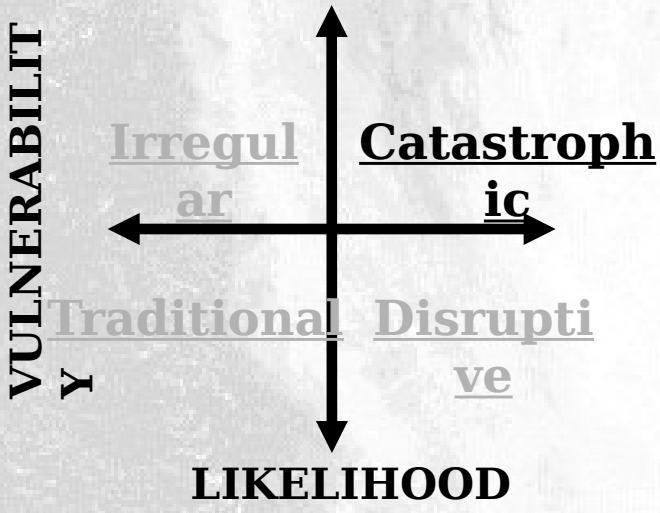
## Issues

- What role for non-military or DoD solutions?
- What is the role of allies i
- Are there viable technical solutions?

## Going Forward

- Expanded SOCOM
- Constabulatory forces (new role or new force)
- Non-lethal technologies – manpower intensive tasks

# Catastrophic Threats…




## Historically

- Rely on distance
- Rely on intel agencies

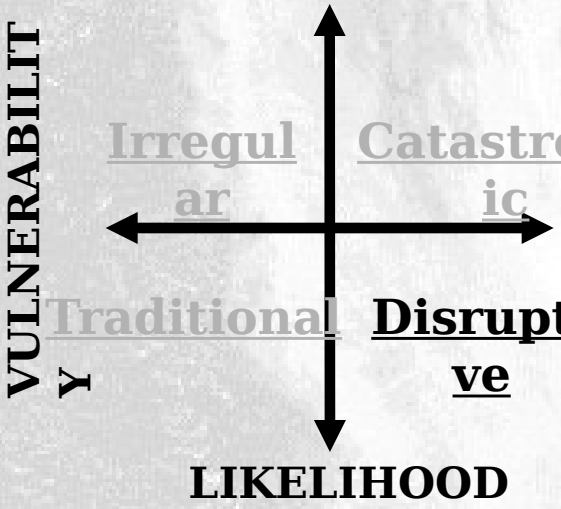
## Issues

- What is your strategy – try to
  prevent/disrupt ahead, try to
  stop, try to absorb
- What is the role of DoD versus
  DHS?

## Going Forward

- Intelligence (IT, knowledge management, etc)
- Missile defense (Cruise missile defense)
- Sensors (wide and narrow area),

# Disruptive Threats…




**Historically**

- **We've been the disruptor**
- **Addressed with government S&T**

**Issues**

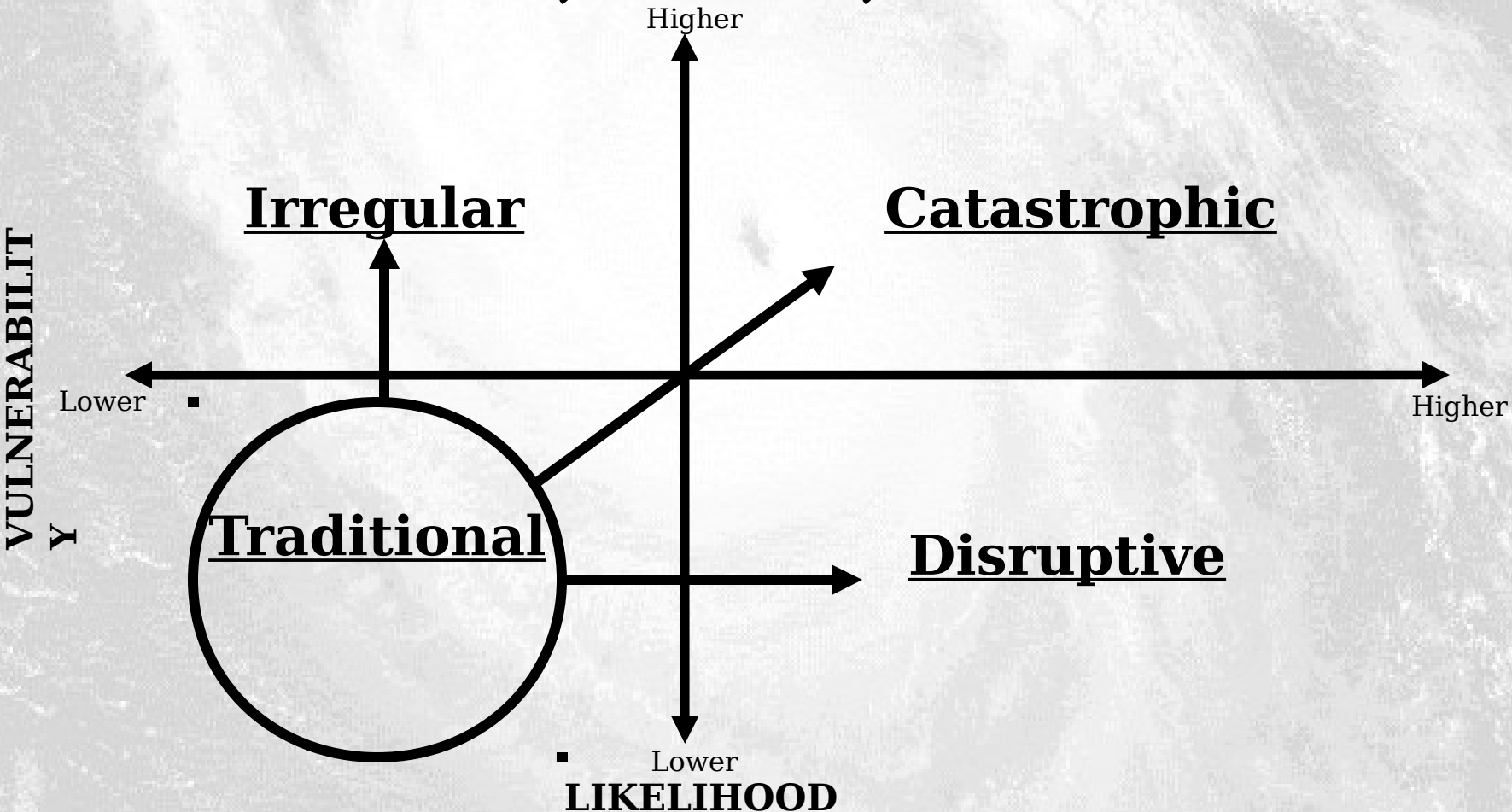
- **Is reliance on harvesting commercial technologies creating vulnerabilities?**
- **Globalization of technology**

**Going Forward**

- **Smaller, smarter, cheaper weapons**
- **Cyber-operations – targeting single poin of failure**
- **Challenge for industry and USG is**

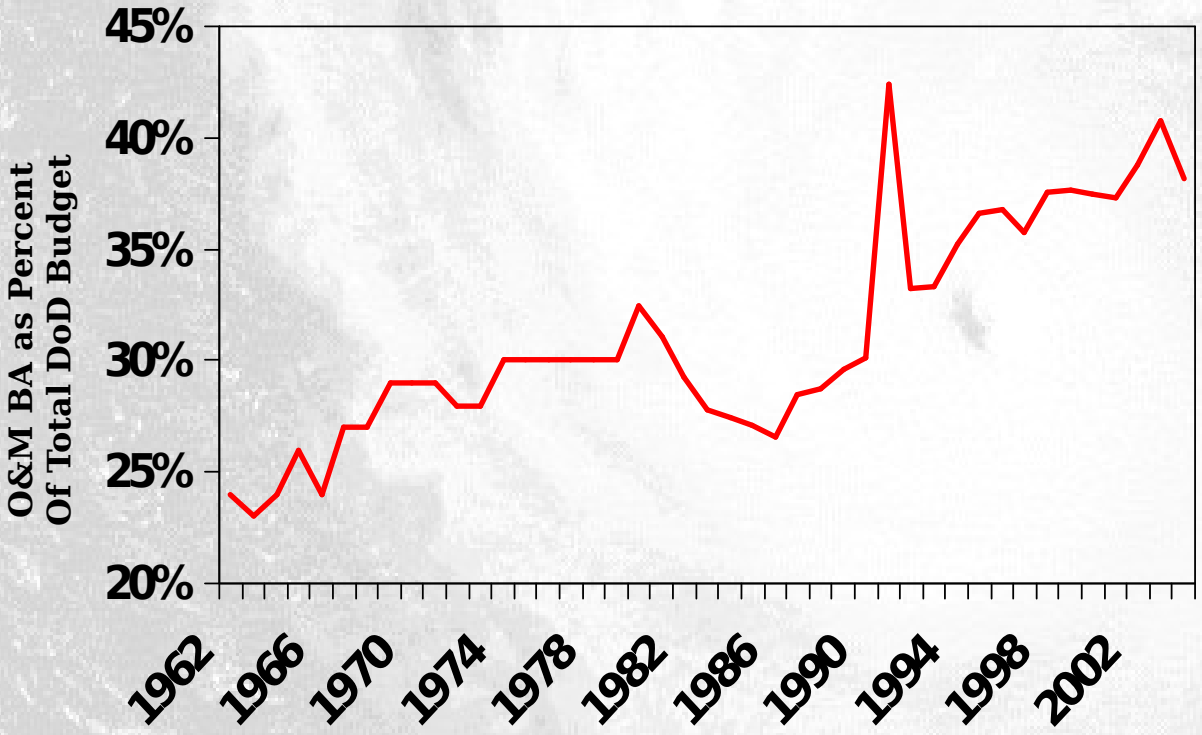
# The Central Question…

- How to reallocate resources
- How much, to where, etc.



# Problem Exacerbated by Pressures On Defense Budget. . .

## The Operations and Maintenance "Death Spiral" Still With Us




| | 1990 (Avg Age) | 2005 (Avg Age) |
|---|---|---|
| Ground Combat Vehicles | ~ 6 yrs | ~14 yrs |
| Marine Combat Vehicles | ~ 5 yrs | ~ 15 yrs |
| AF Fighters | ~ 10 yrs | ~ 18 yrs |
| Navy Aircraft | ~ 11 yrs | ~ 14 yrs |
| AF Bombers | ~ 21 yrs | ~ 30 yrs |
| AF Tankers | ~ 27 yrs | ~ 42 yrs |
| Combat Ships | ~ 16 yrs | ~ 16 yrs |

- **Old equipment increasingly more expensive to maintain**
- **Iraqi War costs adding to the operators & vrs**

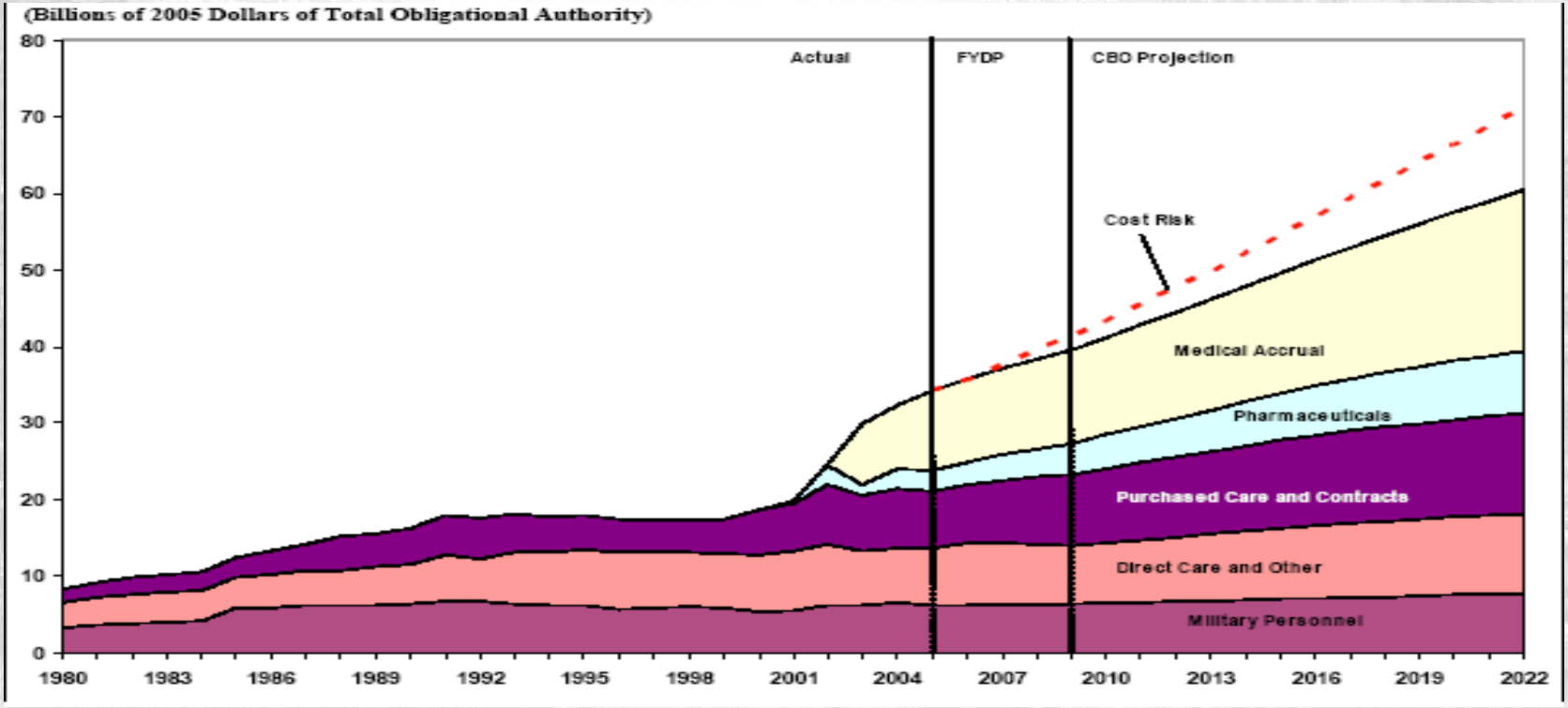
Source: CBO, DoD 2005 Green

# Problem Exacerbated by Pressures On Defense Budget (2). . .

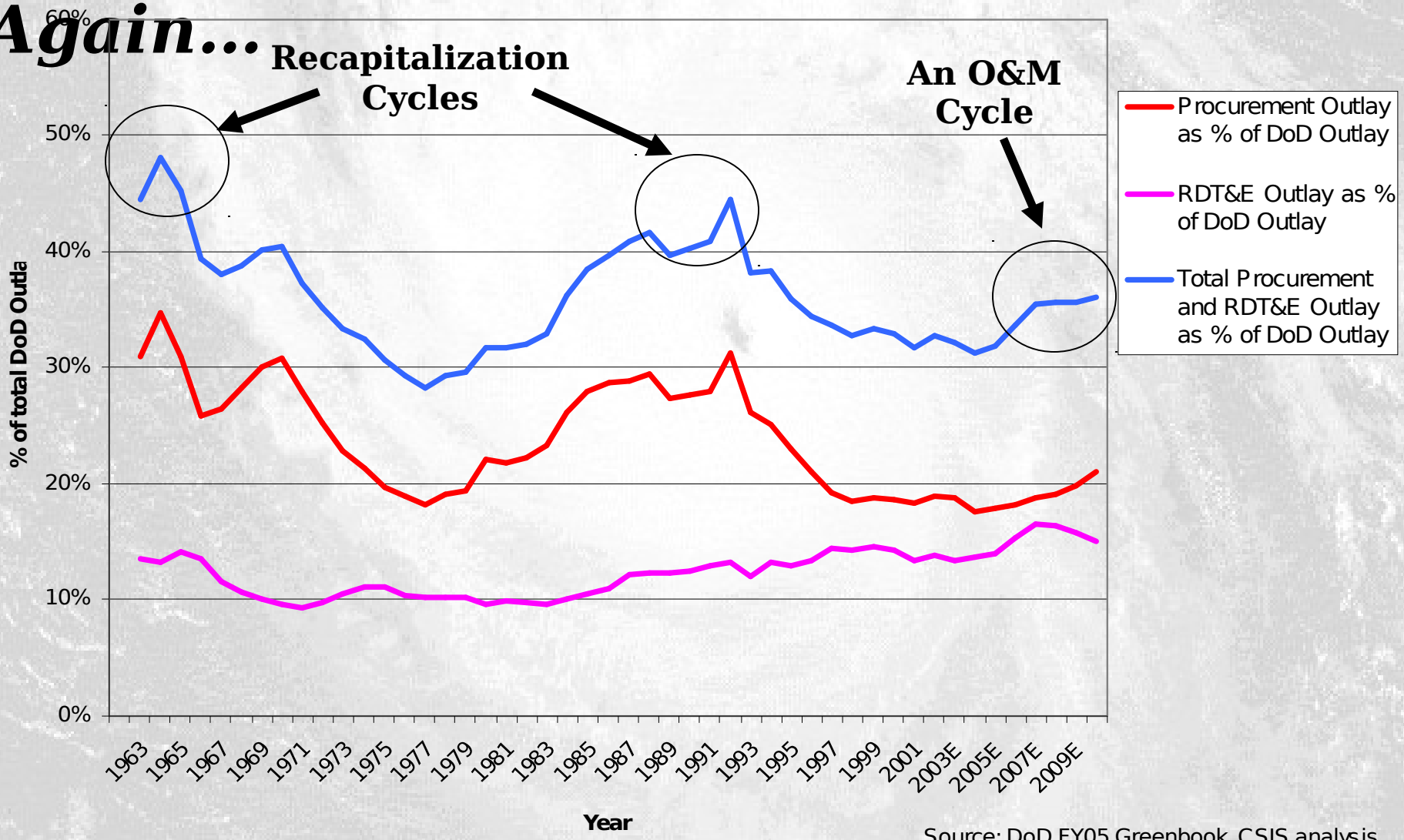
## Growth in Personnel Costs ramping up as well

- End Strength Growth
- Exploding Health Care Costs

**DoD Medical Spending According to CBO**

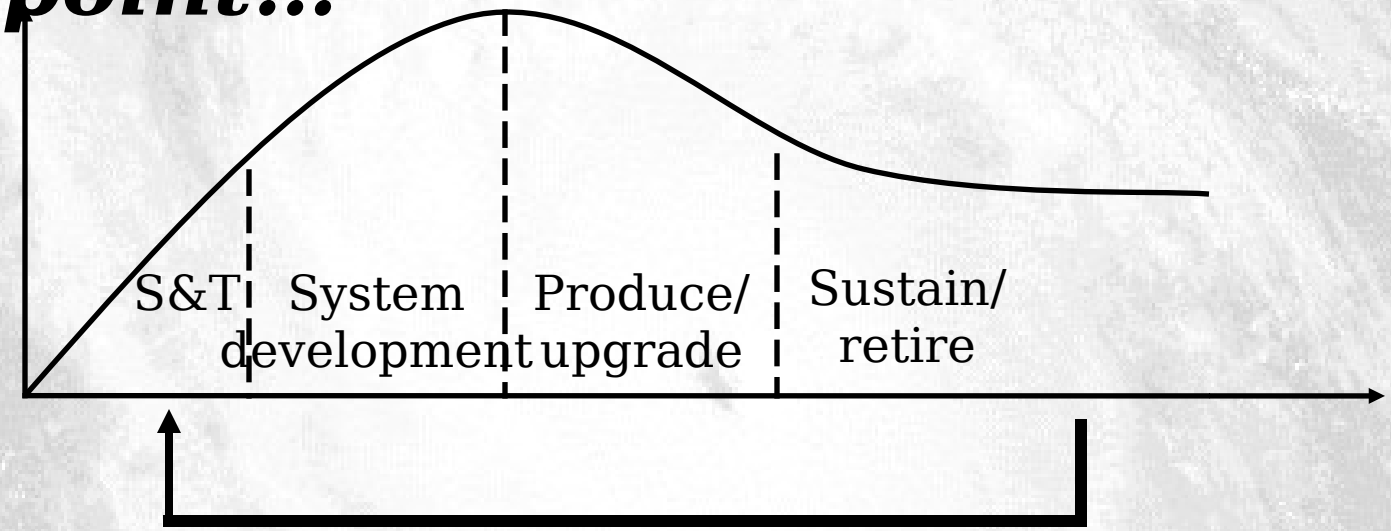


# Investment Accounts the Bill Payer, Again…




Source: DoD FY05 Greenbook, CSIS analysis

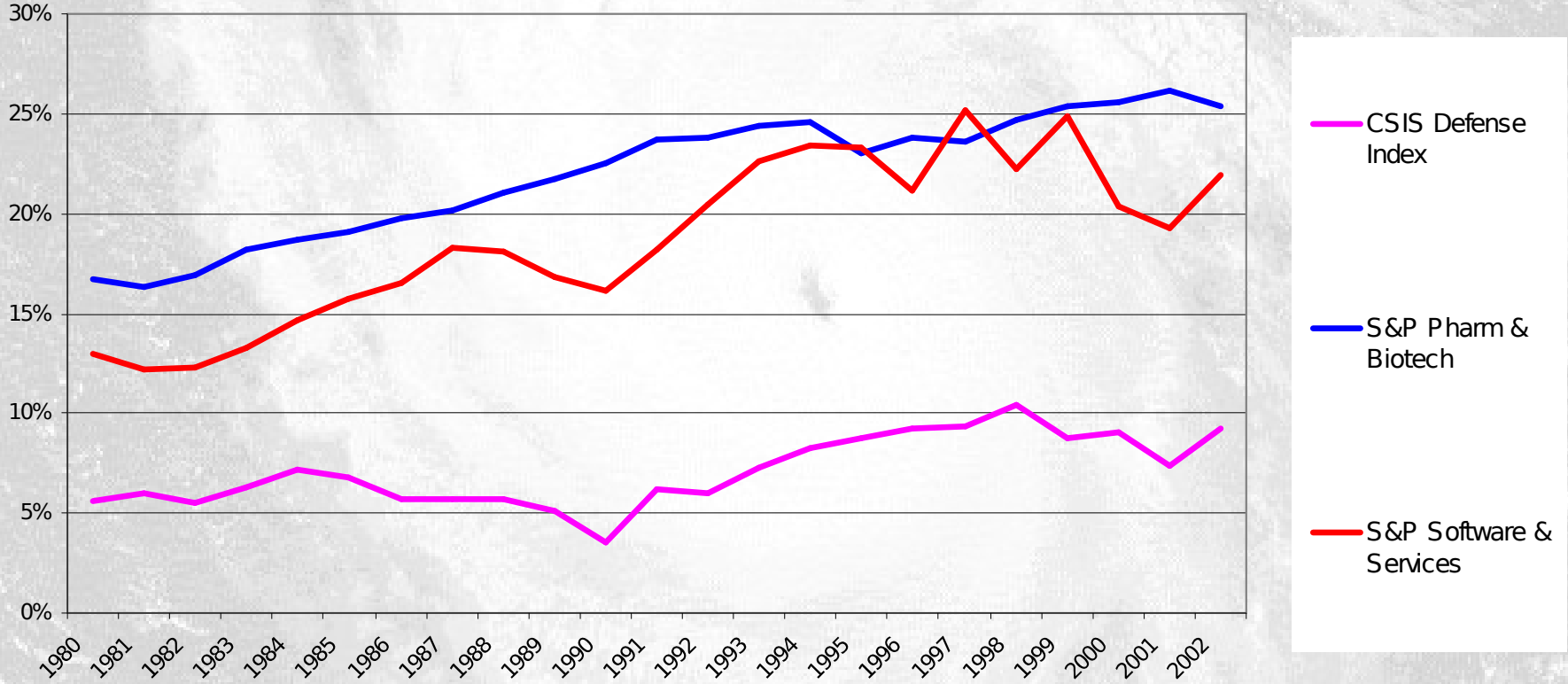
# From the Industry's Standpoint…




- The barriers to reallocation of assets are high
  - Structural disincentives
    - No long production runs
    - R&D not rewarded
  - Political pressures

# Attracting Non-Traditional Players Will Be Difficult…

**Industry Average Operating Margin (weighted by revenue)**




Sources: FactSet, S&P Compustat, Energy Information Administration, CSIS Analysis

Notes: 1) CSIS Defense Index comprises 36 publicly-traded companies with majority revenues derived from US defense business.
(2) S&P Sub-sector constituents accurate back to 1994; composition held constant for years 1980 to 1993.

# *Implications for Industry – GET CREATIVE*

- **In defining solutions**
  - **How to solve non-tradition problems**
  - **How to leverage legacy assets**
  - **Get closer to the end-user**

- **In strategy**
  - **Be conduit for others into the defense world**
  - **More decentralized to address more complex problems**
  - **Venture capital strategy**